

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
PHOENIX, ARIZONA

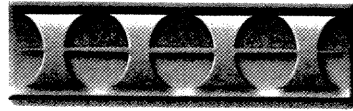
FINANCIAL STATEMENTS
Year Ended June 30, 2004
with Report of Independent Auditors

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA

FINANCIAL STATEMENTS
Year Ended June 30, 2004

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HENRY & HORNE, P.L.C.
Advisors to Business

Independent Auditors' Report

Board of Directors
Water Infrastructure Finance Authority of Arizona
Phoenix, Arizona

We have audited the accompanying financial statements of the Water Infrastructure Finance Authority of Arizona, a discrete component unit of the State of Arizona, as of and for the year ended June 30, 2004, as listed in the table of contents. These basic financial statements are the responsibility of the Water Infrastructure Finance Authority of Arizona's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Infrastructure Finance Authority of Arizona, as of June 30, 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 9 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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CERTIFIED PUBLIC ACCOUNTANTS

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2004, on our consideration of Water Infrastructure Finance Authority of Arizona's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink, appearing to read "Henry H. Hone, P.C.", with a stylized, cursive script.

October 1, 2004

Management's Discussion and Analysis

As management of the Water Infrastructure Finance Authority of Arizona (Authority), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with the Authority's financial statements.

HIGHLIGHTS – BUSINESS TYPE ACTIVITIES

- In 2004, net assets increased by \$32.9 million and total assets increased by \$237.3 million as compared to 2003.
- Total assets increased primarily due to the Authority's bond issuance in April 2004.
- On April 7, 2004, the Authority issued \$195,980,000 in Water Quality Revenue Bonds to fund loans to finance water quality projects in the State of Arizona and \$97,100,000 in Water Quality Revenue Refunding Bonds to refund portions of the Authority's outstanding revenue bonds.

USING THIS ANNUAL REPORT

The financial statements included in this annual report are those of a corporate and politic body of the State of Arizona. The following statements are included:

- Statement of net assets – reports the Authority's current financial resources, noncurrent financial resources, current obligations, long-term obligations, and the resulting net assets
- Statement of revenues, expenses and changes in fund net assets – reports the Authority's program revenues, program expenses, nonprogram revenues, and capital contributions.
- Statement of cash flows – reports the Authority's cash flows from operating activities, investing, and non-capital activities.

STATEMENT OF NET ASSETS

Years Ended June 30,	2004	2003
Cash & Equivalents	\$232,328,770	57,803,870
Investments	68,081,810	73,458,184
Loans	409,169,550	338,555,406
All Other Assets	6,912,812	9,389,410
Total Assets	716,492,942	479,206,870
Bonds Payable	417,400,000	230,280,000
Interest Payable	5,105,470	3,806,903
All Other Liabilities	22,338,261	6,452,799
Total Liabilities	444,843,731	240,539,702
Net Assets Invested in Capital Assets	15,638	25,120
Restricted Capitalization for Grants	199,180,304	199,180,304
Unrestricted	72,453,269	39,461,744
Total Net Assets	\$271,649,211	\$238,667,168

Management's Discussion and Analysis

The Authority's net assets increased to \$271,649,211 during 2004, an increase of \$32,982,043 over 2003. The increase in net assets was primarily the result of capital contributions and loan activities.

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The following table shows the condensed statement of revenues, expenses and changes in net assets for the past two years.

Years Ended June 30,	2004	2003
Program Revenues:		
Program loan interest revenue	\$5,240,954	\$9,228,422
Debt management fees	4,066,852	3,284,787
Total program revenue	9,307,806	12,513,209
Program Expenses:		
Administrative expenses	2,438,171	2,236,300
Technical/financial assistance	813,555	414,490
Program loan interest expense	12,876,283	11,881,633
Total program expenses	16,128,009	14,532,423
Program income	(6,820,203)	(2,019,214)
Non-program revenues	6,663,320	8,678,999
Income before contributions	(156,883)	6,659,785
Capital contributions	33,422,648	5,296,794
Change in net assets	33,265,765	11,956,579
Beginning net assets	238,383,446 **	226,710,589
Ending net assets	\$271,649,211	\$238,667,168

**Restated due to prior period adjustment of (\$283,722).

Compared to 2003, total expenses increased by \$1.6 million. The increase was primarily the result of increased technical assistance expense and expenses associated with the Authority's bonds.

WIFA relied on significant federal capital contributions and bond proceeds to fund loans in 2004 and drew contributions from multiple open federal capitalization grants. In 2003, WIFA primarily relied on fund balances to fund loans.

Management's Discussion and Analysis

BUDGETARY HIGHLIGHTS

On June 18 2003, the Authority's Board of Directors adopted an operating budget of \$1,717,378 for the period July 1, 2003 through June 30, 2004.

<u>Budget Line Item</u>	<u>Amount</u>
Salaries & Benefits	\$1,051,734
Professional & Outside Services	251,846
In State Travel	20,800
Out of State Travel	21,500
Other Operating	229,450
Equipment	94,930
Indirect Cost	47,118
Total	<u>\$1,717,378</u>

CAPITAL ASSETS

The Authority's capital assets consist of computer equipment. In 2004, the Authority purchased \$19,548 of computer equipment and had \$29,032 in depreciation expense.

DEBT OUTSTANDING

As mentioned previously in the Highlights-Business Type Activities, the Authority issued new and refunding bonds in April 2004.

Years Ended June 30,	2004	2003
Beginning balance	\$230,280,000	\$241,855,000
Refunded Bonds	(95,445,000)	-
Refunding Bonds	97,100,000	-
Additions	195,980,000	-
Payments	(10,515,000)	(11,575,000)
Ending balance	<u>\$417,400,000</u>	<u>\$230,280,000</u>

ECONOMIC AND OTHER FACTORS

Drinking Water Standard for Arsenic

In October 2001, the United States Environmental Protection Agency adopted a new standard for the amount of arsenic permissible within drinking water. The new standard decreased the maximum amount of arsenic from 50 parts per billion to 10 parts per billion. According to estimates from the Arizona Department of Environmental Quality, the new arsenic standard will affect approximately 3,000,000 customers of drinking water systems throughout Arizona. Under the current requirements, drinking water systems have until January 23, 2006 to achieve compliance with the new standard or will fall out of compliance and face penalties.

As a result of the need to comply with the new federal standard, the Authority anticipates dramatic increases for its drinking water financial assistance from small water systems. Many of these small water systems will require significant rate increases to accommodate the capital and operating costs associated with arsenic treatment. Accordingly, the Authority anticipates providing financial assistance in 2005.

Authority Automation Efforts

The Authority continues to develop and implement fiscal related applications to automate its financial activity.

Inequity in the Clean Water State Revolving Fund (CWSRF) Capitalization Grant Funding Allocation

Congress appropriates funding to EPA which, in turn, grants allocations to states to capitalize CWSRFs in accordance with state-by-state federally enacted allocation percentages. As originally intended by Congress, CWSRF allocations to states should be based on population and documented needs.

The present allocation percentages are based on a 1977 formula using data from the 1970 census and the 1974 wastewater needs survey. Present allocations favor the Northeast and Midwest regions at the expense of the remainder of the country, particularly the Southeast and Southwest regions. While the population of the U.S. continues to migrate south and west, the vast majority of the funding for infrastructure remains in the Northeast and Midwest.

Based on Census Bureau data, Arizona's 2000 population approximates 5.1 million, ranking 20th for population by state. However, Arizona is 53rd out of 53 for CWSRF allocations per capita.

Based on EPA's 2002 Needs Survey, Arizona certified nearly \$6.3 billion in wastewater infrastructure needs, ranking 10th for needs by state. However, Arizona is 53rd out of 53 for CWSRF Allocations compared to certified need.

Arizona currently receives only 0.68% of the CWSRF appropriation. Based on allocations to states with similar needs, Arizona should receive 3.54% of the CWSRF appropriation, more than five times more than it currently receives.

Management's Discussion and Analysis

A conservative estimate indicates that Arizona has lost over \$216 million in allocations since 1989. In effect, Arizona's taxpayers subsidize infrastructure in other states and pay more for the same infrastructure within Arizona as the result of the funding disparity.

FINANCIAL CONTACT

The Authority's financial statements present users with a general overview of the Authority's finances and demonstrate the Authority's accountability. If you have any questions about the report or require additional financial information, please contact Frank Castro, Controller, Water Infrastructure Finance Authority of Arizona, 1110 West Washington, Suite 290, Phoenix, Arizona 85007 or by phone at (602) 364-1310 or toll-free at (877) 298-0425.

Water Infrastructure Finance Authority of Arizona
Statement of Net Assets
Proprietary Funds
June 30, 2004

ASSETS	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Current assets:				
Cash and cash equivalents:				
Cash with treasurer	\$ 137,441,558	\$ 79,807,507	\$ 15,962	\$ 217,265,027
Cash with trustee	7,815,413	7,248,330	-	15,063,743
Total cash and cash equivalents	145,256,971	87,055,837	15,962	232,328,770
Receivables, net of uncollectibles				
Program loans-current	5,773,192	3,157,613	-	8,930,805
Debt management	347,764	532,567	-	880,331
Interest	2,630,078	807,338	-	3,437,416
Due (to) from other funds	2,421,663	(2,489,863)	68,200	-
Total current assets	156,429,668	89,063,492	84,162	245,577,322
Noncurrent assets:				
Investments	56,692,519	11,389,291	-	68,081,810
Program loans	286,701,558	113,537,187	-	400,238,745
Deferred bond costs	1,854,766	724,661	-	2,579,427
Capital assets (net of depreciation)	7,819	7,819	-	15,638
Total noncurrent assets	345,256,662	125,658,958	-	470,915,620
Total assets	501,686,330	214,722,450	84,162	716,492,942
LIABILITIES				
Current liabilities:				
Accrued payroll	10,155	10,155	-	20,310
Compensated absences	26,399	26,399	-	52,798
Interest payable	3,713,714	1,391,756	-	5,105,470
Bonds payable-current	9,250,800	2,474,201	-	11,725,001
Total current liabilities	13,001,068	3,902,511	-	16,903,579
Noncurrent liabilities:				
Loan reserve	178,873	1,389,322	-	1,568,195
Unamortized bond premiums	19,092,019	10,795,202	-	29,887,221
Deferred amount on retirement of bonds	(6,075,718)	(3,114,545)	-	(9,190,263)
Bonds payable	282,496,953	123,178,046	-	405,674,999
Total noncurrent liabilities	295,692,127	132,248,025	-	427,940,152
Total liabilities	308,693,195	136,150,536	-	444,843,731
NET ASSETS				
Net assets invested in capital assets	7,819	7,819	-	15,638
Restricted for capitalization grants	162,742,085	69,860,867	-	232,602,952
Unrestricted	30,243,231	8,703,228	84,162	39,030,621
Total net assets	\$ 192,993,135	\$ 78,571,914	\$ 84,162	\$ 271,649,211

See accompanying notes.

Water Infrastructure Finance Authority of Arizona
Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Funds
For The Year Ended June 30, 2004

	Business-type Activities-Enterprise Funds			
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	Total
Program revenues:				
Program loan interest revenue	\$ 4,312,974	\$ 927,980	\$ -	\$ 5,240,954
Debt management fees	2,323,022	1,743,830	-	4,066,852
Total program revenues	6,635,996	2,671,810	-	9,307,806
Program expenses:				
Administrative expenses	853,718	1,552,242	-	2,405,960
Depreciation	14,516	14,516	-	29,032
Technical assistance	211,473	413,607	-	625,080
Financial assistance	188,475	-	-	188,475
Program loan interest expense	9,509,760	3,366,523	-	12,876,283
Hardship grant expense	-	-	3,179	3,179
Total program expenses	10,777,942	5,346,888	3,179	16,128,009
Program loss	(4,141,946)	(2,675,078)	(3,179)	(6,820,203)
Nonprogram revenues:				
Administrative grants	527,687	1,169,228	-	1,696,915
Investment earnings	4,033,357	933,048	-	4,966,405
Total nonprogram revenues	4,561,044	2,102,276	-	6,663,320
Income (loss) before contributions and transfers	419,098	(572,862)	(3,179)	(156,943)
Capital contributions-federal	17,933,278	12,570,495	-	30,503,773
Capital contributions-state	979,000	1,939,875	-	2,918,875
Transfers in (out)	(68,200)	-	68,200	-
Change in net assets	19,263,176	13,937,568	65,021	33,265,765
Total net assets-beginning of year	173,223,227	65,424,800	19,141	238,667,168
Prior period adjustment	506,732	(790,454)	-	(283,722)
Total net assets-beginning of year-restated	173,729,959	64,634,346	19,141	238,383,446
Total net assets-end of year	\$ 192,993,135	\$ 78,571,914	\$ 84,162	\$ 271,649,211

Water Infrastructure Finance Authority of Arizona
Statement of Cash Flows
Proprietary Funds
For The Year Ended June 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Receipt of program loans	\$ 28,435,384	\$ 8,670,032	\$ -	\$ 37,105,416
Loans made to borrowers	(85,452,751)	(15,486,241)	-	(100,938,992)
Receipt of debt management fees	2,717,004	1,854,224	-	4,571,228
Receipt of loan reserves	55,866	310,352	-	366,218
Payment of administrative costs	(860,516)	(1,559,618)	-	(2,420,134)
Payment of technical assistance costs	(211,473)	(413,607)	-	(625,080)
Payment of financial assistance costs	(188,475)	-	-	(188,475)
Payment of program loan costs	(8,715,196)	(2,916,248)	-	(11,631,444)
Payment of hardship grant costs	-	-	(3,179)	(3,179)
Net cash used by operating activities	(64,220,157)	(9,541,106)	(3,179)	(73,764,442)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition of capital assets	(9,775)	(9,775)	-	(19,550)
Net cash used by capital and related financing activities	(9,775)	(9,775)	-	(19,550)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Receipt (payment) of interfund activity	12,421,837	(12,421,837)	-	-
Proceeds from sale of bonds	204,769,647	114,779,586	-	319,549,233
Payment for refunding bonds	(66,200,040)	(39,561,060)	-	(105,761,100)
Principal paid on bonds	(8,158,150)	(2,356,850)	-	(10,515,000)
Receipt of administrative grants	527,687	1,169,228	-	1,696,915
Capital contributions	18,912,278	14,510,370	-	33,422,648
Net cash provided by noncapital financing activities	162,273,259	76,119,437	-	238,392,696
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest received on investments	3,543,218	996,604	-	4,539,822
Net sale (purchase) of investments	9,195,215	(3,818,841)	-	5,376,374
Net cash provided (used) by investing activities	12,738,433	(2,822,237)	-	9,916,196
Net increase (decrease) in cash and cash equivalents	110,781,760	63,746,319	(3,179)	174,524,900
Cash and cash equivalents at beginning of year	34,475,211	23,309,518	19,141	57,803,870
Cash and cash equivalents at end of year	<u>\$ 145,256,971</u>	<u>\$ 87,055,837</u>	<u>\$ 15,962</u>	<u>\$ 232,328,770</u>

See accompanying notes.

Water Infrastructure Finance Authority of Arizona
Statement of Cash Flows
Proprietary Funds
For The Year Ended June 30, 2004

	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Reconciliation of program loss to net cash used by operating activities:				
Program loss	\$ (4,141,946)	\$ (2,675,078)	\$ (3,179)	\$ (6,820,203)
Adjustments to reconcile program loss to net cash used by operating activities:				
Depreciation	14,516	14,516	-	29,032
Amortization of bond related costs	60,645	(114,373)	-	(53,728)
(Increase) decrease in:				
Program loans	(62,524,888)	(8,863,853)	-	(71,388,741)
Debt management receivable	393,982	110,394	-	504,376
Interest receivable	1,194,547	1,119,664	-	2,314,211
Increase (decrease) in:				
Accounts payable	(5,970)	(6,547)	-	(12,517)
Accrued payroll	2,100	2,100	-	4,200
Compensated absences	(2,928)	(2,929)	-	(5,857)
Interest payable	733,919	564,648	-	1,298,567
Loan reserve	55,866	310,352	-	366,218
Total adjustments	(60,078,211)	(6,866,028)	-	(66,944,239)
Net cash used by operating activities	\$ (64,220,157)	\$ (9,541,106)	\$ (3,179)	\$ (73,764,442)

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Water Infrastructure Finance Authority of Arizona (WIFA) is a political body and a component unit of the State of Arizona (State). WIFA's financial information is discretely presented in the Comprehensive Annual Financial Report of the State of Arizona. It is authorized to administer the Clean Water Revolving Fund and The Drinking Water Revolving Fund (Fund). WIFA is governed by a twelve-member board of directors. The day-to-day administrative functions of WIFA are overseen by WIFA's Executive Director and other staff employed by WIFA.

The Clean Water Revolving Fund was created pursuant to the Federal Water Pollution Control Act of 1972, as amended by the Water Quality Act of 1987 (Clean Water Act), which required the State of Arizona to establish the Fund to accept federal capitalization grants for publicly owned wastewater treatment projects. The purpose of the fund is to provide financial assistance, including loans to political subdivisions and Indian tribes to finance construction, acquisition, restoration or rebuilding of wastewater treatment facilities.

WIFA has an agreement with the Environmental Protection Agency to administer the Drinking Water Revolving Fund pursuant to the Safe Drinking Water Act. The fund was established to provide water facility loans including forgivable principal to political subdivisions of this state, Indian Tribes and other eligible entities as determined by the board pursuant to the Safe Drinking Water Act, make drinking water facility loans, purchase or refinance debt obligations of drinking water facilities, assist in purchasing insurance for local drinking water facility bond obligations, pay the costs to administer the fund, fund other programs pursuant to the Safe Drinking Water Act and provide linked deposit guarantees through third party lenders with recourse against deposit if payments are not made when due.

The Funds are authorized to be capitalized through (i) moneys, if any, appropriated by the State Legislature, (ii) federal capitalization grants and other federal moneys received by WIFA to fund the Fund, (iii) proceeds of WIFA's bonds, including bonds issued to provide matching State moneys as required by the Clean Water Act, (iv) moneys received from political subdivisions or Indian tribes as repayment of loans from the Fund, including interest and penalties thereon, (v) interest and other income received from investing moneys of the Fund, and (vi) gifts, grants and donations received from any public or private source. In order to receive federal capitalization grants, the State must provide matching funds in a ratio of \$1 of State matching funds for every \$5 of federal capitalization grants. The State began appropriating money for deposit into the Funds in 1998. Previously the State matching funds were provided from proceeds of the WIFA's capitalization bonds.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reporting Entity (Continued)

The accompanying financial statements present the Clean Water Revolving Fund, Drinking Water Revolving Fund and the Hardship Grant Fund, which includes all of the revenues and the administrative expenses of WIFA.

Fund Type

WIFA plans to maintain the federal capitalization grants as the fund's restricted net assets. Therefore, the periodic determination of revenues earned, expenses incurred, and changes in net assets are appropriate for capital maintenance, public policy, management control, accountability and other purposes. As a result, the accounting records are maintained as an enterprise fund. Only earnings from the administrative grants, debt management fees and interest earned on accumulated excess administrative income can be expended for expenses or utilized to match federal grants.

WIFA distinguishes program revenues and expenses from non-program items. Program revenues and expenses generally result from providing services in connection with financing and administering moneys for the Clean and Drinking Water Revolving Funds. The principal program revenues of WIFA are program loan interest and management fees. WIFA's program expenses are administrative, program loan costs and grant related expenses. All revenues and expenses not meeting this definition are reported as non-program revenues and expenses.

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. WIFA's financial statements are reported using the economic resources measurement focus. WIFA's accounting records are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when they are incurred. Pursuant to GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, the WIFA follows GASB guidance as applicable to proprietary funds, and Financial Accounting Standards Boards Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB Pronouncements.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

WIFA has adopted provisions of Statement No. 31 of the Governmental Accounting Standards Board (GASB), Accounting and Financial Reporting for Certain Investments and for External Investment Pools. The new standard requires certain investments to be reported at fair value rather than at cost.

Investments in Guaranteed Investment Contracts are stated at cost, since they are non-participating contracts. The investment of excess revenue in the 2001 Master Trust Indenture is stated at fair value, which approximates cost.

Cash Equivalents

WIFA considers all highly liquid debt instruments purchased with maturities of three months or less at acquisition date to be cash equivalents. Cash equivalents are stated at cost, which approximates market.

Capital Assets

Capital assets acquired by the Funds are stated at cost. The capitalization threshold has been set at \$5,000. Depreciation has been allocated using the straight-line method over the following estimated useful lives:

Computer and Peripheral Equipment	3 - 5 years
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Compensated Absences

WIFA employees accrue vested annual leave at a variable rate based on years of service. Employees forfeit accumulated annual leave in excess of 320 hours at the end of a calendar year. Any employee who separates from WIFA service is paid for all unused and unforfeited annual leave at the employee's rate of pay at the time of separation.

Sick leave includes any approved period of paid absence granted an employee due to illness, injury or disability. Employees accrue sick leave at the rate of eight hours per month without an accumulation limit. Because sick leave benefits do not vest with employees, a liability for sick leave is not accrued in the financial statements.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long-term Obligations

Long-term debt is reported as fund liabilities in the applicable fund's statement of net assets. Bond premiums, bond issuance costs and loss on retirement of bonds are deferred and amortized over the life of the bonds using the straight-line method.

Net Assets

WIFA restricts amounts received from the federal and state government for the purpose of providing financial assistance for publicly owned wastewater treatment and water facilities.

Grants

Grants restricted for program loans are recorded as contributions. Grants that are used for operating purposes are recorded as revenue. Federal grants for project related expenses might not be drawn until qualifying expenditures are incurred.

Fund Administration

Employees of WIFA perform administration of the Funds. Expenses relating to the administration are funded from the capital facility grant (up to a maximum of 4 percent of the capital facility grant) and fees charged to loan recipients (see Note 9).

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 2 CASH HELD BY TRUSTEE AND STATE TREASURER

The Funds maintain their cash held by trustee in an irrevocable trust account in the name of WIFA held by the trust department of a financial institution located in Phoenix, Arizona (separate from all other funds and investments of the trustee). These balances are directed by the State Treasurer to be invested in a full faith and credit money market fund that is not insured by the Federal Deposit Insurance Corporation or collateralized by the trustee. The balance at June 30, 2004, primarily represented moneys transferred from investments on June 30, 2004, for the payment of interest on the bonds on July 1, 2004 or to fund program loans. The cash held by the State Treasurer is invested in the State Agency's pool number 3. A copy of the audited financial statements may be obtained by contacting the Office of the State Treasurer.

NOTE 3 INVESTMENTS

The State Treasurer directs the Funds' cash and investments. ARS 35-312 and ARS 35-313 require the State Treasurer to invest in obligations of the U.S. or its agencies including sponsored agencies, corporations, sponsored corporations or instrumentalities; collateralized repurchase agreements, bonds or other evidence of indebtedness of the State of Arizona or its political subdivisions; commercial paper, bankers acceptances, certificates of deposit, interest-bearing savings accounts and bonds, debentures, notes and other evidences of indebtedness issued by U.S. corporations meeting certain rating criteria. The Fund's investments at June 30, 2004, consisted of collateralized guaranteed investment contracts issued by domestic banks, a monoline insurer and insurance company, and a foreign bank acting through its New York branch. The guaranteed investment contracts are not insured by the Federal Deposit Insurance Corporation.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 3 INVESTMENTS (Continued)

	Interest Rate	Final Maturity Date	June 30, 2004	Withdrawal Dates	Issuer
Guaranteed Investment Contracts:					
Foreign banks:					
1995 capital grant account	5.484	07/01/09	\$ 2,109,005	B	C
1997 capital grant account	4.936	07/01/17	9,918,125	A	C
1999 debt service reserve fund	5.760	10/01/17	708,375	A	C
1999 guaranteed investment contract	5.760	10/01/17	<u>27,850,000</u>	B	C
			<u>40,585,505</u>		
Domestic banks:					
1992 capital grant account	5.715	07/01/12	2,343,794	B	D
2001 debt service reserve fund	6.220	10/01/08	11,467,864	A	F
2004 debt service reserve fund	4.581	10/01/24	<u>13,684,647</u>	A	F
			<u>27,496,305</u>		
			<u>\$68,081,810</u>		

Investments applicable to the Funds are as follows:

Clean Water	\$ 56,692,519
Drinking Water	<u>11,389,291</u>
	<u>\$ 68,081,810</u>

A - Only at maturity dates, to cure deficiencies, or by mutual consent. This fund can be increased or decreased to equal maximum annual debt service through maturity of all bonds.

B - Can be withdrawn for program costs at anytime.

C - Bayerische Landesbank

D - Morgan Guarantee Trust Company of New York

E - AIG Matched Funding Corp.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 3 INVESTMENTS (Continued)

If any of the bank's credit rating falls below levels defined in the investment contracts, the State Treasurer may direct the bank to enter into a repurchase agreement with the Trustee pursuant to which the bank shall sell and deliver to the Trustee certain U.S. government obligations in a principal amount equal to invested moneys and accrued interest. If the rating falls below "A" the Trustee shall have the right to withdraw all amounts invested and accrued interest.

NOTE 4 PROGRAM LOANS

The Funds have made loans to local governments and others in Arizona to finance various projects pursuant to the requirements of the Clean Water and Safe Drinking Water Acts. The loans are generally payable in semiannual installments due January 1 and July 1 of each year, including interest. However, several loans are payable monthly or quarterly. Changes in the program loans are as follows:

	<u>July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2004</u>
Clean Water Fund	\$229,934,005	\$ 85,452,751	\$(22,912,006)	\$292,474,750
Drinking Water Fund	<u>108,621,401</u>	<u>15,486,241</u>	<u>(7,412,842)</u>	<u>116,694,800</u>
	<u>\$338,555,406</u>	<u>\$100,938,992</u>	<u>\$(30,324,848)</u>	<u>\$409,169,550</u>

Repayment of these loans will be made from pledged property taxes, net revenues from the systems, transaction privilege taxes or from special assessments. Most loans have a .3 to 4.0 percent annual administrative fee.

Some program loans require a monthly or quarterly payment into a debt service reserve to assure payments of the loans. The debt service reserve is a liability of WIFA to the borrowers and interest on the reserve accrues to the borrowers.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 5 CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
<u>Clean Water Fund</u>				
Computers & Peripheral Equipment	\$ 40,959	\$ 9,775	\$ -	\$ 50,734
Less Accumulated Depreciation	(28,399)	(14,516)	-	(42,915)
Clean Water Capital Assets, net	\$ 12,560	\$ (4,741)	\$ -	\$ 7,819
<u>Drinking Water Fund</u>				
Computers & Peripheral Equipment	\$ 40,959	\$ 9,775	\$ -	\$ 50,734
Less Accumulated Depreciation	(28,399)	(14,516)	-	(42,915)
Drinking Water Capital Assets, net	\$ 12,560	\$ (4,741)	\$ -	\$ 7,819
<u>Clean and Drinking Water Funds</u>				
Computers & Peripheral Equipment	\$ 81,918	\$ 19,550	\$ -	\$ 101,468
Less Accumulated Depreciation	(56,798)	(29,032)	-	(85,830)
Clean and Drinking Water Capital Assets, net	\$ 25,120	\$ (9,482)	\$ -	\$ 15,638

NOTE 6 COMPENSATED ABSENCES

The compensated absences activity for June 30, 2004 was as follows:

Compensated Absences for:	July 1, 2003	Additions	Reductions	June 30, 2004	Estimated Current Portion
Clean Water	\$ 29,327	\$ 23,159	\$ 26,088	\$ 26,399	\$ 26,399
Drinking Water	29,328	23,159	26,089	26,399	26,399
Total	\$ 58,655	\$ 46,318	\$ 52,177	\$ 52,798	\$ 52,798

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 7 RETIREMENT AND PENSION PLAN

Arizona State Retirement Plan

Plan Description. The Arizona State Retirement System (ASRS) administers a cost sharing multiple-employer defined benefit pension plan that covers employees of WIFA. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. ASRS issues a publicly available report that includes financial statements and required supplementary information. The report may be obtained in writing at ASRS, 3300 N. Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910 or by calling 602-240-2200 or 1-800-621-3778.

Funding Policy. The Arizona State Legislature has the authority to establish and amend benefits provisions and contributions for active plan members. For the years ended June 30, 2003, 2002 and 2001, active ASRS members and WIFA were each required by statute to contribute at the actuarially determined rate of 5.20, 2.49 and 2.49 percent (rate includes .50 percent long-term disability for 2004 and .49 percent for 2003 and 2002), respectively, of the members' annual covered payroll. WIFA's contributions to ASRS for the years ended June 30, 2004, 2003 and 2002 were \$39,431, \$14,209 and \$12,273, respectively.

NOTE 8 BONDS PAYABLE

Bonds payable at June 30, 2004 are summarized below. The bonds are callable and interest is payable semiannually. The bonds are special obligations of WIFA payable solely from and secured by the Fund's assets. The obligations are not obligations, general, specific or otherwise, of the State of Arizona or any other political subdivision thereof other than WIFA.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

\$5,500,000 Financial Assistance Revenue Bonds, Series 1992 A, due in annual principal installments ranging from \$300,000 to \$950,000, plus semiannual interest ranging from 5.20% to 5.95% through July 1, 2004.	\$ 315,000
\$670,000 Capitalization Revenue Bonds Series 1992 A, due in annual principal installments ranging from \$70,000 to \$165,000, plus semiannual interest ranging from 5.20% to 5.80% through July 1, 2004.	90,000
\$3,270,000 Financial Assistance Revenue Bonds, Series 1995, due in annual principal installments ranging from \$225,000 to \$410,000, plus semiannual interest ranging from 4.40% to 5.50% through July 1, 2009.	2,160,000
\$585,000 Capitalization Revenue Bonds, Series 1995, due in annual principal installments ranging from \$80,000 to \$125,000, plus semiannual interest ranging from 4.40% to 5.00% through July 1, 2005.	280,000
\$9,730,000 Financial Assistance Revenue Bonds, Series 1996A, due in annual principal installments ranging from \$360,000 to \$1,870,000, plus semiannual interest ranging from 3.70% to 5.50% through July 1, 2012.	9,730,000
\$1,135,000 Capitalization Revenue Bonds, Series 1996A, due in annual principal installments ranging from \$140,000 to \$385,000, plus semiannual interest ranging from 3.70% to 5.00% through July 1, 2005.	605,000
\$20,125,000 Financial Assistance Revenue Bonds, Series 1997A, due in annual principal installments ranging from \$845,000 to \$1,415,000, plus semiannual interest ranging from 4.20% to 6.1% through July 1, 2008.	5,985,000
\$3,330,000 Capitalization Revenue Bonds, Series 1997A, due in annual principal installments ranging from \$335,000 to \$625,000, plus semiannual interest ranging from 4.20% to 4.65% through July 1, 2005.	960,000

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

\$35,370,000 Financial Assistance Revenue Bonds, Series 1998A, due in annual principal installments ranging from \$1,985,000 to \$2,190,000, beginning July 1, 1999, plus semiannual interest ranging from 3.8% to 5% through July 1, 2008.	9,815,000
\$64,000,000 Water Quality Revenue Refunding Bonds, Series 1999, due in annual principal installments ranging from \$2,330,000 to \$8,190,000, plus semiannual interest ranging from 4.0% to 5.625% through October 1, 2017.	56,935,000
\$110,000,000 Water Quality Revenue Bonds, Series 2001A, due in annual principal installments ranging from \$3,780,000 to \$8,075,000, plus semiannual interest ranging from 4.0% to 5.375% through October 1, 2011.	37,445,000
\$97,100,000 Water Quality Revenue Refunding Bonds, Series 2004, due in annual principal installments ranging from \$125,000 to \$4,825,000, plus semi annual interest ranging from 2.0% to 5.0% through October 1, 2021.	97,100,000
\$195,980,000 Water Quality Revenue Bonds, Series 2004, due in annual principal installments ranging from \$5,500,000 to \$15,080,000, plus semi annual interest ranging from 2.0% to 5.0% through October 1, 2024	<u>195,980,000</u>
	<u>\$ 417,400,000</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

A summary of changes in bonds payable is set forth below:

	<u>July 1, 2003</u>	<u>Issued</u>	<u>Retired</u>	<u>Refunded</u>	<u>June 30, 2004</u>
Financial Assistance Revenue					
Bonds Series 1992 A	\$ 4,590,000	\$ -	\$ 305,000	\$ 3,970,000	\$ 315,000
Capitalization Revenue Bonds					
Series 1992 A	445,000	-	95,000	260,000	90,000
Financial Assistance Revenue					
Bonds Series 1995	2,455,000	-	295,000	-	2,160,000
Capitalization Revenue Bonds					
Series 1995	360,000	-	80,000	-	280,000
Financial Assistance Revenue					
Bonds Series 1996A	9,730,000	-	-	-	9,730,000
Capitalization Revenue Bonds					
Series 1996A	745,000	-	140,000	-	605,000
Financial Assistance Revenue					
Bonds Series 1997A	16,320,000	-	315,000	9,420,000	5,985,000
Capitalization Revenue Bonds					
Series 1997A	1,315,000	-	355,000	-	960,000
Financial Assistance Revenue					
Bonds Series 1998A	30,550,000	-	1,935,000	18,800,000	9,815,000
Water Quality Refunding					
Bonds Series 1999	59,265,000	-	2,330,000	-	56,935,000
Water Quality Revenue					
Bonds Series 2001A	104,505,000	-	4,065,000	62,995,000	37,445,000
Water Quality Revenue					
Bonds Series 2004A	-	195,980,000	-	-	195,980,000
Water Quality Refunding					
Bonds Series 2004A	-	97,100,000	-	-	97,100,000
	<u>\$ 230,280,000</u>	<u>\$ 293,080,000</u>	<u>\$ 10,515,000</u>	<u>\$ 95,445,000</u>	<u>\$ 417,400,000</u>

Bonds by Fund are as follows:

Arizona Clean Water Revolving Fund	\$ 291,747,753
Arizona Drinking Water Revolving Fund	<u>125,652,247</u>
	<u>\$ 417,400,000</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

The Clean Water Fund's bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Clean Water		
	Principal	Interest	Total
2005	\$ 9,250,800	\$ 13,368,980	\$ 22,619,780
2006	20,390,322	12,953,630	33,343,952
2007	18,407,793	12,256,573	30,664,366
2008	16,678,405	11,530,538	28,208,943
2009	17,240,555	10,769,878	28,010,433
2010-2014	83,526,063	41,759,675	125,285,738
2015-2019	72,502,205	21,674,050	94,176,255
2020-2024	50,197,660	5,990,488	56,188,148
2025-2029	3,553,950	73,300	3,627,250
Total Long-Term Debt	291,747,753	130,377,112	422,124,865
Less Current Portion	(9,250,800)	(13,368,980)	(22,619,780)
Noncurrent Portion	\$ 282,496,953	\$ 117,008,132	\$ 399,505,085

The Drinking Water Fund's bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Drinking Water		
	Principal	Interest	Total
2005	\$ 2,474,201	\$ 5,505,516	\$ 7,979,717
2006	8,124,677	5,415,662	13,540,339
2007	6,702,206	5,192,952	11,895,158
2008	6,346,595	4,951,127	11,297,722
2009	6,429,445	4,674,560	11,104,005
2010-2014	34,108,937	18,639,213	52,748,150
2015-2019	30,542,794	10,938,149	41,480,943
2020-2024	28,977,342	3,301,762	32,279,104
2025-2029	1,946,050	40,137	1,986,187
Total Long-Term Debt	125,652,247	58,659,078	184,311,325
Less Current Portion	(2,474,201)	(5,505,516)	(7,979,717)
Noncurrent Portion	\$ 123,178,046	\$ 53,153,562	\$ 176,331,608

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

WIFA's total bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Total Clean and Drinking Water		
	Principal	Interest	Total
2005	\$ 11,725,001	\$ 18,874,496	\$ 30,599,497
2006	28,514,999	18,369,292	46,884,291
2007	25,109,999	17,449,525	42,559,524
2008	23,025,000	16,481,665	39,506,665
2009	23,670,000	15,444,438	39,114,438
2010-2014	117,635,000	60,398,888	178,033,888
2015-2019	103,044,999	32,612,199	135,657,198
2020-2024	79,175,002	9,292,250	88,467,252
2025-2029	5,500,000	113,437	5,613,437
Total Long-Term Debt	417,400,000	189,036,190	606,436,190
Less Current Portion	(11,725,001)	(18,874,496)	(30,599,497)
Noncurrent Portion	\$ 405,674,999	\$ 170,161,694	\$ 575,836,693

On September 8, 1999, WIFA issued \$64,000,000 of Water Quality Refunding Bonds to do an advance refunding of the 1991A bonds and part of the 1992A, 1995A and 1996A bonds. Under the terms of the refunding issue, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government Securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The amount outstanding on those bonds as of June 30, 2004 is \$19,230,000. These bonds have been fully defeased.

The net present value cash flow for savings on issuing the refunding bonds at a 5.271% bond yield was \$237,387.

The \$1,687,938 deferred amount on retirement of bonds is being amortized over the lives of the defeased bonds on the straight-line basis. The amortization for the year ended June 30, 2004 is \$141,618 and has been included in interest expense.

On April 7, 2004, WIFA issued \$97,100,000 of Water Quality Refunding Bonds to do an advance refunding part of the 1992, 1997A, 1998A and 2001 bonds. Under the terms of the refunding issue, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government Securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The amount outstanding on those bonds as of June 30, 2004 is \$97,100,000. These bonds have been fully defeased.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 8 BONDS PAYABLE (Continued)

The net present value cash flow for savings on issuing the refunding bonds at a 3.213% bond yield was \$3,120,247.

The \$8,335,990 deferred amount on retirement of bonds is being amortized over the lives of the defeased bonds on the straight-line basis. No amortization for the year ended June 30, 2004 was taken on the deferred amount.

NOTE 9 ADMINISTRATIVE REVENUES AND EXPENSES

WIFA is authorized to utilize a portion of the facility grant as an administrative grant (not to exceed 4% of the net capital facility grant). These funds are deposited to an administrative grant account maintained by WIFA which is accounted for in a separate fund at the treasurer's office.

WIFA also receives a loan origination fee on most loans and servicing fees assessed on the outstanding loan balance from each of the Local Borrowers (Debt Management Revenue). These fees are used to defray program administration expenses, and are collected and recorded by WIFA as separate funds at the treasurer's office.

The administrative expenses reported by WIFA for the year ended June 30, 2004 are as follows:

EXPENSES:	Clean Water Fund	Drinking Water Fund	Total
Personnel	\$ 388,127	\$ 368,502	\$ 756,629
Benefits	93,434	88,531	181,965
Contracts	120,815	72,907	193,722
In State Travel	5,153	6,681	11,834
Out of State Travel	7,609	6,844	14,453
Other operating expenses	120,613	103,777	224,390
Capital and non-capital equipment	27,917	27,917	55,834
Indirect cost	20,000	20,000	40,000
Other operating expenses	70,050	-	70,050
Subtotal	853,718	695,159	1,548,877
Set aside to ADEQ	-	857,083	857,083
	<u>\$ 853,718</u>	<u>\$ 1,552,242</u>	<u>\$ 2,405,960</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

NOTE 10 AMORTIZATION OF BOND COSTS AND BOND PREMIUMS

WIFA has incurred costs for issuance of bonds, which were not passed on to the borrowers. Such costs are being amortized over the life of the bonds on the straight-line basis. Amortization has been offset against interest expense. Annual amortization for the following bonds is \$76,143 and \$20,231 for Clean Water Revolving and Drinking Water Revolving Funds, respectively. The details follow:

	July 1, 2003	New Issue	Refunded	Amortization	June 30, 2004
Clean Water Fund:					
1996A Bonds	\$ 95,059	\$ -	\$ -	\$ 7,504	87,555
1997 Bonds	77,000	-	43,721	5,500	27,779
1998 Bonds	34,395	-	21,680	2,487	10,228
1999 Bonds	574,748	-	-	40,571	534,177
2001 Bonds	364,809	-	209,504	20,081	135,224
2004 Bonds	-	1,059,803	-	-	1,059,803
Drinking Water Fund:					
1998 Bonds	12,955	-	6,974	937	5,044
2001 Bonds	350,503	-	207,731	19,294	123,478
2004 Bonds	-	596,139	-	-	596,139
	<u>\$ 1,509,469</u>	<u>\$ 1,655,942</u>	<u>\$ 489,610</u>	<u>\$ 96,374</u>	<u>\$ 2,579,427</u>

Bond premiums are being amortized over the life of the bonds. Annual amortization for the following bonds is \$157,116 and \$134,604 for Clean Water Revolving and Drinking Water Revolving Funds, respectively. The details follow:

	July 1, 2003	New Issue	Refunded	Amortization	June 30, 2004
Clean Water Fund:					
1998 Bonds	\$ 109,002	\$ -	\$ 68,774	\$ 7,786	\$ 32,442
1999 Bonds	158,143	-	-	11,163	146,980
2001 Bonds	2,233,572	-	1,273,455	138,167	821,950
2004 Bonds	-	18,090,647	-	-	18,090,647
Drinking Water Fund:					
1998 Bonds	25,966	-	13,991	1,855	10,120
2001 Bonds	2,145,982	-	1,262,679	132,749	750,554
2004 Bonds	-	10,034,528	-	-	10,034,528
	<u>\$ 4,672,665</u>	<u>\$ 28,125,175</u>	<u>\$ 2,618,899</u>	<u>\$ 291,720</u>	<u>\$ 29,887,221</u>

Amortization of the deferred amount on the refunded bonds is being written off over the life of the new issue. Current year's amortization for the Clean Water Revolving Fund was \$141,618.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

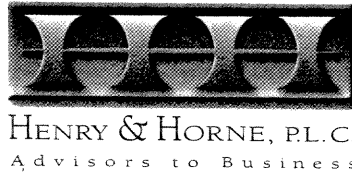
NOTE 11 PRIOR PERIOD ADJUSTMENTS

One of WIFA's borrowers refinanced their loan in a prior period. In that process, part of the balance of the old loan was not removed from the program loan receivables. The net affect of this adjustment to net assets was \$790,454.

In a prior period WIFA recognized an administrative draw from grant funds as deferred revenue. The funds were used for program loans and not for administrative expenses. Revenue recognition is required when funds are drawn regardless of the manner in which the funds were used. The net affect of this adjustment to net assets was \$506,732.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA
PHOENIX, ARIZONA

COMPLIANCE REPORT
Year Ended June 30, 2004



REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Water Infrastructure Finance Authority of Arizona
Phoenix, Arizona

We have audited the financial statements of the Water Infrastructure Finance Authority of Arizona as of and for the year ended June 30, 2004, and have issued our report thereon dated October 1, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Water Infrastructure Finance Authority of Arizona's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Water Infrastructure Finance Authority of Arizona's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have

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CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Water Infrastructure Finance Authority of Arizona
Phoenix, Arizona

reported to management of Water Infrastructure Finance Authority of Arizona, in a separate letter dated October 1, 2004.

This report is intended solely for the information of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Henry Hone, P.C.", with a stylized flourish at the end.

October 1, 2004